

Before the
FEDERAL COMMUNICATIONS COMMISSION
 Washington, D.C.

JUN 18 1999

FEDERAL COMMUNICATIONS COMMISSION
 OFFICE OF THE SECRETARY

In the Matter of)
)
 The Establishment of Rules to Prohibit)
 the Imposition of Unjust, Onerous)
 Termination Penalties on Customers)
 Choosing to Partake of the Benefits)
 of Local Exchange Telecommunications)
 Competition)

CC Docket No. 99-142

REPLY COMMENTS OF KMC TELECOM INC.

KMC Telecom Inc. ("KMC") submits these reply comments in the above captioned proceeding concerning whether the Commission should preempt state actions approving or enforcing termination penalties imposed by incumbent LECs that constitute barriers to entry under Section 253 of the Act.¹ Initial comments demonstrate that termination penalties imposed by incumbent LECs constitute a barrier to competitive entry. KMC requests that the Commission pursuant to Section 253(d) of the Act preempt any state action approving or enforcing these termination penalties. These preemptions would effectively establish a "fresh look" opportunity for customers locked into long-term contract or tariff service arrangements by these termination penalties.

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¹*Establishment of Rules to Prohibit the Imposition of Unjust, Onerous Termination Penalties on Customers Choosing to Partake of the Benefits of Local Exchange Telecommunications Competition*, KMC Telecom Inc. Petition for Declaratory Ruling, Dkt. No. 99-142 (filed April 26, 1999) ("Petition").

I. KMC'S ABILITY TO PROVIDE SERVICE IS THWARTED BY ILEC TERMINATION PENALTIES

In its Petition, KMC extensively described termination penalties that effectively prevent customers from switching to competitive service providers. Other parties provided numerous examples of the anti-competitive effects of termination penalties.² To further emphasize its point, KMC provides the following additional illustrative examples and can provide more if requested by the Commission. A Sprint customer in Tallahassee, Florida with a monthly phone bill of approximately \$2000 would have faced a termination penalty of more than \$44,000. A BellSouth customer in Baton Rouge, Louisiana with monthly charges of approximately \$1750 would have been assessed a penalty of more than \$52,000 if it switched to KMC.

The impact of these termination penalties is illustrated by the affidavit of Mr. Dewayne Fowler, a KMC Account Executive, which is attached hereto. Mr. Fowler states that he has elicited considerable interest in KMC from incumbent LEC customers only later to have their interest withdrawn after their realization of the termination charges. In one instance, a Southwestern Bell (SWBT) customer in Topeka, Kansas worked with Mr. Fowler and signed a contract with KMC. At that time, Mr. Fowler believed that KMC would assume the contract and that therefore the customer would not be liable for any termination penalties. Subsequently, a different KMC

²Comments of Allegiance Telecom, Inc. at 2; Joint Comments of CTSI, Inc. and RCN Telecom Services, Inc. at 3; Joint Comments of Choice One Communications and Hyperion Telecommunications, Inc. at 2; Joint Comments of the Association for Local Telecommunications Services, Net2000 Communications, Inc., and Teligent, Inc. at 2-3; Comments of Columbia Telecommunications, Inc. d/b/a aXessa at 1; Comments of Fairpoint Communications Corp at 2-3; Comments of McLeodUSA Telecommunications Services, Inc. at 2; Comments of MCG Communications Inc. at 3-5; Comments of Telecommunications Resellers Association at 3; Comments of Qwest Communications Corporation at 4.

customer was assessed termination penalties by an incumbent carrier under similar circumstances, so Mr. Fowler advised the customer to contact SWBT to inquire about the possibility of termination penalties. It was thereafter determined that a penalty of approximately \$35,000 would be assessed. KMC voluntarily released the customer from their agreement.

Thus, the record in this proceeding contains ample evidence that competitive LECs are effectively thwarted in their ability to provide service to customers due to the imposition of termination penalties. Accordingly, the Commission should reject arguments that the record in this proceeding does not provide evidence that termination penalties can prevent new entrants from providing competitive services.³

II. PREEMPTION IS WARRANTED UNDER SECTION 253

A. Incumbent LEC Termination Penalties Have the Effect of Prohibiting Competitive Entry

Section 253(a) of the Act provides that "[n]o state or local statute or regulation, or other State or local legal requirement may prohibit or have the effect of prohibiting the ability of any entity to provide any interstate or intrastate telecommunications service."⁴ To determine whether a legal requirement "has the effect of prohibiting" the ability of an entity to provide local service, the Commission considers "whether the [legal requirement] materially inhibits or limits the ability of any competitor or potential competitor to compete in a fair and balanced legal and regulatory environment."⁵ KMC submits that the imposition of termination penalties on customers by

³Opposition of Bell Atlantic at 7-8; BellSouth Comments at 8; Comments of Southwestern Bell Telephone, Pacific Bell, Nevada Bell and Southern New England Telephone at 6.

⁴ 47 U.S.C. Section 253(a).

⁵*California Payphone Association Petition for Preemption of Ordinance No. 576 NS of the City of Huntington Park, California Pursuant to Section 253(d) of the Communications Act of 1934*, 12 FCC Rcd 14191 (July 17, 1997) at ¶ 31.

incumbent LECs materially inhibits competitive LECs from providing service. Thus, as explained, KMC is effectively prohibited from providing service to customers who cannot realistically consider obtaining service from competing providers if they are subject to excessive incumbent LEC termination penalties the primary purpose of which is to assure that customers do not consider switching to other carriers.

B. State Approval or Enforcement of Termination Penalties Constitute "State Legal Requirements" That May be Preempted

Several incumbent LECs state that state commissions permitted their imposition of termination penalties on customers. In their Joint Comments, Southwestern Bell Telephone, Pacific Bell, Nevada Bell and Southern New England Telephone explain that "... this Commission and state regulatory commission have routinely approved such arrangements because of the additional customer servicing options they provide" ⁶ Thus, it appears that some state commissions have specifically approved termination penalties imposed by incumbent LECs.

KMC submits that these approvals constitute "state legal requirements" that may be preempted under Section 253 because in approving these termination penalties, or permitting them to be imposed, states have established a legal requirement that customers are subject to them.

In addition, it is clear that any state efforts to enforce termination penalties would constitute a state legal requirement subject to Section 253(a). State enforcement would directly require customers to pay termination penalties. Thus, enforcement of termination penalties constitutes "a state legal requirement" that may be preempted under Section 253.

⁶Comments of Southwestern Bell Telephone, Pacific Bell, Nevada Bell and Southern New England Telephone at 3. *See also*, Opposition of Bell Atlantic at fn. 6; Comments of GTE at 3; Southwestern Bell Telephone, Pacific Bell, Nevada Bell and Southern New England Telephone Southwestern Bell Telephone, Pacific Bell, Nevada Bell and Southern New England Telephone at fn. 6.

KMC further submits that the Commission may in this proceeding establish a prospective preemption of state enforcement actions. The Commission has established prospective preemptions in other proceedings.⁷ Nothing in Section 253 or its legislative history suggests that the Commission is limited to addressing past or current state actions under that section. Instead, it may identify state actions that violate Section 253 and preempt them prospectively.

III. THE COMMISSION MAY FASHION NARROW RELIEF

KMC urges the Commission to establish a “fresh look” opportunity for customers of incumbent LEC long term contracts that will permit them to terminate long-term contracts without liability for payment of any termination penalties. This “fresh look” can effectively be established by preempting, pursuant to Section 253, state approval or enforcement of incumbent LEC termination penalties. KMC urges the Commission to make this “fresh look” opportunity as broad as possible in order to promote the goals of the Act. However, to the extent necessary, the Commission may choose to circumscribe the scope of this preemption as described below.

The Commission could identify a regulatory event and provide that any services initiated

⁷See e.g., *Amendment of Section 64.702 of the Commission's Rules and Regulations (Computer III)*, Report and Order, CC Docket No. 85-229, Phase I, 104 FCC 2d 958 (1986) (*Phase I Order*), recon., 2 FCC Rcd 3035 (1987) (*Phase I Recon. Order*), further recon., 3 FCC Rcd 1135 (1988) (*Phase I Further Recon. Order*), second further recon., 4 FCC Rcd 5927 (1989) (*Phase I Second Further Recon.*), *Phase I Order and Phase I Recon. Order*, vacated, *California v. FCC*, 905 F.2d 1217 (9th Cir. 1990) (*California I*); Phase II, 2 FCC Rcd 3072 (1987) (*Phase II Order*), recon., 3 FCC Rcd 1150 (1988) (*Phase II Recon. Order*), further recon., 4 FCC Rcd 5927 (1989) (*Phase II Further Recon. Order*), *Phase II Order vacated, California I*, 905 F.2d 1217 (9th Cir. 1990); *Computer II Remand Proceedings*, 5 FCC Rcd 7719 (1990) (*ONA Remand Order*), recon., 7 FCC Rcd 909 (1992); *pets. for review denied, California v. FCC*, 4 F3d 1505 (9th Cir. 1993) (*California II*); *Computer III Remand Proceedings: Bell Operating Company Safeguards and Tier 1 Local Exchange Company Safeguards*, 6 FCC Rcd 7571 (1991) (*BOC Safeguards Order*), recon. dismissed in part, *Order*, 11 FCC Rcd 12513 (1996); *BOC Safeguards Order vacated in part and remanded, California v. FCC*, 39 F.3d 919 (9th Cir. 1994) (*California III*), cert. denied, 115 S.Ct. 1427 (1995) (referred to collectively as the *Computer III proceeding*).

prior to event would be eligible for the “fresh look.” KMC suggests that the Commission consider using Section 271 approval for a state as a benchmark for this purpose. Thus, the Commission could provide that incumbent LEC termination penalties may not be enforced in a state with respect to any services initiated prior to the time an incumbent LEC receives Section 271 approval for that state. The Commission could seek to identify this regulatory event based on practicality and feasibility of implementation.

The Commission could also seek to define the type of termination penalties the enforcement of which would be preempted. The Commission could preempt enforcement of incumbent LEC termination penalties that require the customer to continue to pay for services as if the customer were still receiving service. These restrictions are unreasonable, were designed to prevent customers from switching to competitive providers, and have no cost justification. Incumbent LECs failed to justify or explain this method of calculating termination penalties in their comments.

The Commission might provide that incumbent LECs may charge only for service provided. This would permit incumbent LECs to impose termination penalties that require the customer to make up the difference, if any, based on the original term of service and what the customer actually received. In other words, if a tariff provides that a customer shall pay \$100/month for a five year contract and \$110/month for a three year contract and the customer ordered service under a five year plan but terminated in three years, then the termination penalty would be a back-charge of \$10/month for the three years of the contract.

The Commission could also narrow the scope of the preemption to contracts or tariff term plans of a certain length or longer. KMC suggests that the Commission consider providing that enforcement of termination penalties in contracts of 18 months or longer be preempted.

IV. "FRESH LOOK" IS AN APPROPRIATE REGULATORY TOOL

The Commission has used "fresh look" to promote competition with respect to matters within its authority under Sections 201-205 or Title III of the Communications Act.⁸ For example, in concluding that access markets should be opened to competition, the Commission granted a "fresh look" to customers subject to long-term contractual arrangements for special access services.⁹ The Commission stated:

Therefore, we find that continuation of such termination provisions without the modifications specified herein (the fresh look) would be unjust and unreasonable in violation of the Communications Act. Accordingly, we prescribe the termination measures described herein, including the maximum just and reasonable charges for the customers specified herein. Sections 201-205 of the Communications Act empower the Commission to adopt rules and regulations regarding the reasonableness of tariffed LEC offerings, including termination charge provisions. Moreover, the Commission may take this step consonant with Section 205 of the Act.¹⁰

The Commission has ordered a "fresh look" in the context of examining competition in the 800 service market¹¹ and in several other proceedings relating to CMRS providers and air to ground radio-telephone providers. KMC urges the Commission to establish a "fresh look" as described above pursuant to Section 253 in order to promote competition in provision of local services.

⁸*Freedom Ring, LLC*, DR 96-420, Order No. 22,798 (NH PUC, Dec. 8, 1997); *Establishment of Local Exchange Competition and Other Competitive Issues*, Case NO. 95-485-TP-COI, *Entry on Rehearing* (OH PUC, Feb. 20, 1997).

⁹*Expanded Interconnection with Local Telephone Company Facilities*, 7 FCC Rcd 7369 (1992).

¹⁰*Id.* at n.468.

¹¹*Competition in the Interstate Interexchange Marketplace*, 6 FCC Rcd at 5906 n.234.

V. A "FRESH LOOK" WOULD NOT VIOLATE THE CONTRACTS CLAUSE

BellSouth contends that a "fresh look" would violate the Contracts Clause.¹² However, as the Supreme Court has stated:

[It is a] well-settled principle that contracts with public utilities are made subject to the reserved authority of the state, under the police power of express statutory authority or constitutional authority, to modify the contract in the interest of the public welfare without constitutional impairment of the contracts.¹³

As the Supreme Court has also stated "[o]ne whose rights, such as they are, are subject to state restriction cannot remove them from the power of the State by making a contract about them."¹⁴ Incumbent LECs are subject to public utility regulation so that their contractual relationships may be modified by state action as is necessary to promote the public interest. Moreover, the Contracts Clause only applies to state action. Accordingly, if the Commission determines that enforcement of certain incumbent LEC contract practices ought to be preempted under Section 253, it may do so without violating the Contracts Clause.

VI. FRESH LOOK DOES NOT CONSTITUTE A "TAKING"

An impermissible taking may occur where the government regulates property of a regulated utility in a manner that creates the "functional equivalent" of an "ouster."¹⁵ Whether regulation raises taking concerns is determined by examination of the value of the business *as a whole*. A

¹²BellSouth Comments at 7.

¹³*Midland Realty Co. v. Kansas City Power & Light Co.*, 300 U.S. 109, 112 (1937); *see also* *Arkansas Natural Gas Co. v. Arkansas Railroad Comm'n*, 261 U.S. 379, 382 (1923); *see Connolly v. Pension Benefit Guaranty Corp.*, 475 U.S. 211, 224 (1986) (application of proper regulatory authority may not be defeated by private contractual obligations); *Energy Reserves Group, Inc. v. Kansas Power and Light Co.*, 459 U.S. 400, 412 (1983); *City of Charleston v. Pub. Serv. Comm'n of West Virginia*, 57 F.3d 385, 394 (4th Cir. 1995) (finding no substantial impairment of contract).

¹⁴*Hudson Water Co. v. McCarter*, 209 U.S. 349, 257 (1908).

¹⁵*Yee v. Escondido*, 503 U.S. 519, 522 (1992).

taking cannot occur unless a rate order *taken as a whole* produces overall rates so low as to “jeopardize the financial integrity of the [regulated] companies, either by leaving them insufficient operating capital or by impeding their ability to raise future capital.”¹⁶ As the New Hampshire Public Utilities Commission recently held, a “fresh look” does not violate the Takings Clause because it does not “jeopardize the financial integrity of [the incumbent LEC], as is necessary to create the functional equivalent of a taking.”¹⁷ Not one of the incumbent LECs has alleged, nor can they reasonably allege, that the preemption of certain state requirements or the adoption of a fresh look would cause any such an impact. Accordingly, the Commission should reject incumbent LECs’ arguments on this issue.

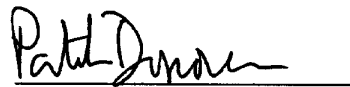
¹⁶*Duquesne Light Co. v. Barasch*, 488 U.S. 299 (1989); *see also Federal Power Comm’n v. Texaco, Inc.*, 417 U.S. 380, 390-391 (1974); *Federal Power Comm’n v. Hope Natural Gas*, 420 U.S. 591, 602, 605 (1974); *FPC v. Natural Gas Pipeline Co. of Am.*, 315 U.S. 575, 607 (1942).

¹⁷*Order Granting Fresh Look Opportunity for Certain Bell Atlantic Customers*, Order No. 22,798, at 3-4 (N.H. P.U.C. Dec. 8, 1997).

VII. CONCLUSION

For the foregoing reasons, KMC respectfully requests that the Commission conclude that incumbent LEC termination penalties as described above effectively prohibit competitive LECs' ability to provide service and that it preempt any state action approving or enforcing such termination penalties.

Respectfully submitted,



Patrick Donovan
Kathleen L. Greenan
Swidler Berlin Shereff Friedman, LLP
3000 K Street, N.W., Suite 300
Washington, D.C. 20007
(202) 424-7500 (Tel)
(202) 424-7645 (Fax)

Dated: June 18, 1999

Counsel for KMC Telecom Inc.

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AFFIDAVIT OF DEWAYNE FOWLER

I, Dewayne Fowler, being duly sworn, do hereby depose and state as follows:

1. I am an Account Executive for KMC Telecom Inc. ("KMC"). As an Account Executive, I market KMC's telecommunications services to prospective business customers in the Topeka, Kansas metropolitan area.
2. The majority of the prospective customers that I contact in the Topeka area currently receive their telecommunications services from Southwestern Bell Telephone Company ("SWBT").
3. Some of businesses that I contact have long-term contract service arrangements ("CSAs") with SWBT for some or all of their telecommunications services. In my experience, these contracts provide for substantial termination penalties against the customer if it elects to switch to a competing local exchange carrier, such as KMC, prior to the expiration of the contract period.
4. The provisions for calculating termination penalties in these SWBT CSAs are confusing to both myself and the SWBT customers. In many cases, the prospective customer must contact SWBT to request a calculation of these charges.

5. Because I know that CSAs typically include substantial termination penalties, I know that I will be unable to market successfully KMC's services to most businesses that have entered such agreements with SWBT.

6. Some representatives of the businesses that have CSAs with SWBT are not aware of the existence of the contract, or are aware of the contract but not of the provision for termination penalties. Therefore, I have often engaged in detailed conversations with these representatives and elicited considerable interest in KMC service from them, only later to have their interest withdrawn after their realization of the SWBT termination charges.

7. In one instance, a SWBT contract customer signed an agreement with KMC for the provision of telecommunications services. At that time, I believed that KMC would be able to assume the contract and that therefore the customer would not be liable for any termination penalties. Subsequently, I learned that a different KMC customer had been assessed termination penalties by an incumbent carrier under what I understood to be similar circumstances. Therefore, I recommended to my customer that it contact SWBT to inquire about the possibility of termination penalties. The customer contacted SWBT and learned that it would be assessed a penalty of 50% of the monthly charge for the remaining months on its contract. After I discussed this issue with the customer, we agreed that the customer would remain with SWBT for the duration of their contract. Were it not for the threat of the SWBT termination penalties, the customer would have switched immediately to KMC service.

8. Expansion into the contract service arrangement market is an important element in KMC's business plan. Unfortunately, KMC is confronted with a formidable barrier to entry in this market because SWBT has locked up nearly all of this market with its long-term contract service arrangements. Most of these contracts were signed at a time when the end-users did not have a meaningful choice of providers for their

telecommunications services. Therefore, the SWBT termination penalties have the effect of denying KMC a fair opportunity to compete in the contract telecommunications market.

I declare that the foregoing statements are true and correct based upon my knowledge, information, and belief.

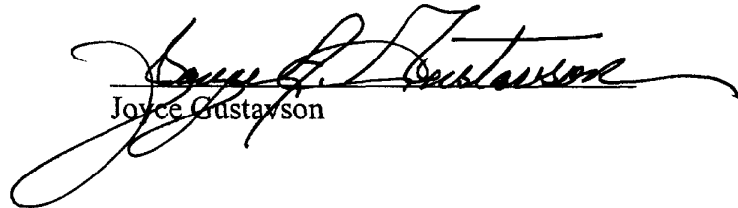
Dewayne Fowler
Account Executive
KMC Telecom Inc.

Sworn to and subscribed before me this ____ day of June, 1999.

Notary Public
My Commission expires:

CERTIFICATE OF SERVICE

I, Susie Gustavson, do hereby certify that on this 18th day of June, 1999, a copy of the foregoing Reply Comments of KMC Telecom Inc. in the Matter of The Establishment of Rules to Prohibit the Imposition of Unjust, Onerous Termination Penalties on Customers Choosing to Partake of the Benefits of Local Exchange Telecommunications Competition was served on the parties on the attached list via hand delivery (indicated by "*") or first class mail, postage pre-paid.



Joyce Gustavson

Chairman William Kennard*
Federal Communications Commission
The Portals
445 12th Street, SW, 8-B201
Washington, D.C. 20554

Commissioner Susan Ness*
Federal Communications Commission
The Portals
445 12th Street, SW, 8-B115
Washington, D.C. 20554

Commissioner Michael Powell*
Federal Communications Commission
The Portals
445 12th Street, SW, 8-A204
Washington, D.C. 20554

Commissioner Harold Furchtgott-Roth*
Federal Communications Commission
The Portals
445 12th Street, SW, 8-A302
Washington, D.C. 20554

Commissioner Gloria Tristani*
Federal Communications Commission
The Portals
445 12th Street, SW, 8-C302
Washington, D.C. 20554

Magalie Roman Salas, Secretary*
Federal Communications Commission
The Portals
445 12th Street, SW, TWA-325
Washington, D.C. 20554

Janice M. Myles*
Common Carrier Bureau
Federal Communications Commission
The Portals
445 12th Street, SW, 5-C327
Washington, D.C. 20554

International Transcription Service*
Federal Communications Commission
1231 20th Street, N.W.
Washington, D.C. 20554

Emily M. Williams
Association For Local
Telecommunications Services
Suite 900
888 17th Street, N.W.
Washington, D.C. 20006

David S. Turetsky
Teligent, Inc.
Suite 400
8065 Leesburg Pike
vienna, VA 22182

Jason R. Karp, Esq.
Net2000 Communications, Inc.
8180 Greensboro Drive
Suite 500
McLean, VA 22102

Gunnar Halley, Esq.
Willkie Farr & Gallagher
Three Lafayette Centre
1155 21st Street, N.W.
Suite 600
Washington, D.C. 20036

Kent F. Heyman, VP & General Counsel
Scott A. Sarem, Assistant Vice President
Richard Heatter, Assistant Vice President
Tracey Buck-Walsh, Associate Legal Counsel
MGC Communications, Inc.
3301 N. Buffalo Drive
Las Vegas, NV 89129

Jonathan E. Canis
Ross A. Buntrock
Kelley Drye & Warren LLP
1200 19th Street, N.W.
Fifth Floor
Washington, D.C. 20036

Edward Shakin
Michael E. Glover
1320 North Court House Road
Eighth Floor
Arlington, VA 22201

Ted Moninski
Director, Regulatory Affairs
ATU Telecommunications
600 Telephone Avenue, M.S. #8
Anchorage, AK 99503

Lawrence G. Malone, General Counsel
Nancy Russell, Assistant Counsel
Public Service Commission of
the State of New York
Three Empire State Plaza
Albany, New York 12223-1350

Robert B. McKenna
Jeffrey A. Brueggeman
Suite 700
1020 - 19th Street, N.W.
Washington, D.C. 20036

M. Robert Sutherland
Richard M. Sbaratta
BellSouth Corporation
BellSouth Telecommunications, Inc.
1155 Peachtree Street, N.E.
Suite 1700
Atlanta, Georgia 30309-3610

John F. Raposa
GTE Service Corporation
600 Hidden Ridge, HQE03J27
P.O. Box 152092
Irving, TX 75015-2092

Gail L. Polivy
GTE Service Corporation
1850 M Street, N.W.
Washington, D.C. 20036

Robert M. Lynch
Roger K. Toppins
Mark Royer
One Bell Plaza, Room 3024
Dallas, Texas 75202

Tiki Gaugler
Federal Regulatory Attorney
Jane Kunka
Manager, Public Policy
Qwest Communications Corp.
4250 North Fairfax Drive
Arlington, VA 22203

Jay C. Keithley
1850 M Street, N.W., 11th Floor
Washington, D.C. 20036-5807

Sandra K. Williams
4220 Shawnee Mission Parkway
Suite 303A
Westwood, KS 66205

Charles C. Hunter
Catherine M. Hannan
Hunter Communications Law Group
1620 I Street, N.W.
Suite 701
Washington, D.C. 20006

Kenneth E. Hardman
Moir & Hardman
1828 L Street, N.W., Suite 901
Washington, D.C. 20036-5104

Frank J. Miller
Andrew D. Fisher
Huber Lawrence & Abell
605 Third Avenue
New York, NY 10158

David R. Conn
VP - Law and Regulatory Affairs
McLeodUSA Telecommunications Services, Inc.
McLeodUSA Technology Park
6400 C Street SW
Cedar Rapids, IA 52406-3177